



Julius Bär

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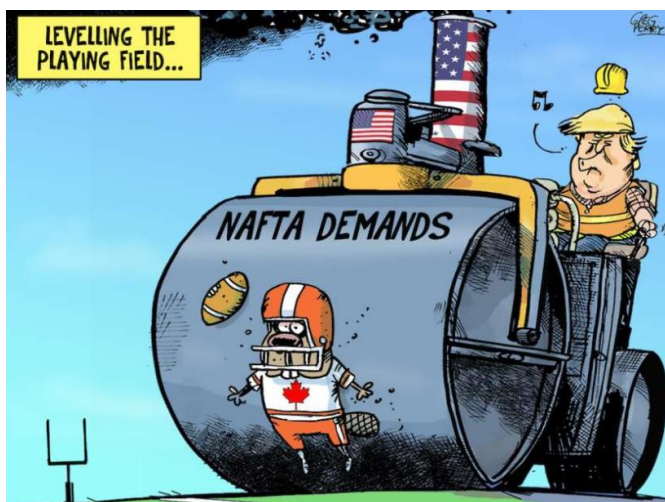
CURRENCIES & MORE OUR INSIGHT INTO THE WORLD'S LARGEST MARKET

Loonie: Rewind 30 years and the US and Canada were standing at the same crossroads with NAFTA
Dollar: The debt ceiling debate continues under the era of Trump with no certain outcome
Safe haven: Increased volatility in the franc indicates it surpassing the yen as a safe haven currency

Loonie: The NAFTA question continues

In today's C&M and on the second day of NAFTA negotiations we shed more light on the U.S. – Canada issues. Rewind 30 years to October 1, 1987. Days before the U.S. and Canada signed their biggest trade deal, then Prime Minister Brian Mulroney walked away from the negotiating table with the US. The high-stakes gamble was to force the US into a dispute-settlement mechanism which would allow Canada to resolve trade conflicts outside US courts. The gamble worked and days later the deal was signed.

U.S. NAFTA Demands



Source: Greg Perry / Leaderpost

Fast forward to today and Justin Trudeau, current Canadian Prime Minister, is facing the same crossroads again. Trump confirmed that his top objective was to remove the

dispute-resolution mechanism. Interestingly enough, Canada has only initiated three cases under the provision, leading Robert Wolfe, professor emeritus at Queen University's School of Policy Studies in Kingston, Ontario, to call for another gamble. He suggests the dispute-settlement mechanism is not essential to Canada and they should trade it for gaining concessions on Trump's "Buy American" rules, which restrict Canadian companies to bid on US government contracts. Canada could bluff with the mechanism to ultimately give in and receive the ability to bid instead. It is suggested that a lot of Canadian jobs could benefit from that. Negotiations have only just started and we are unlikely to see an agreement in the coming weeks.

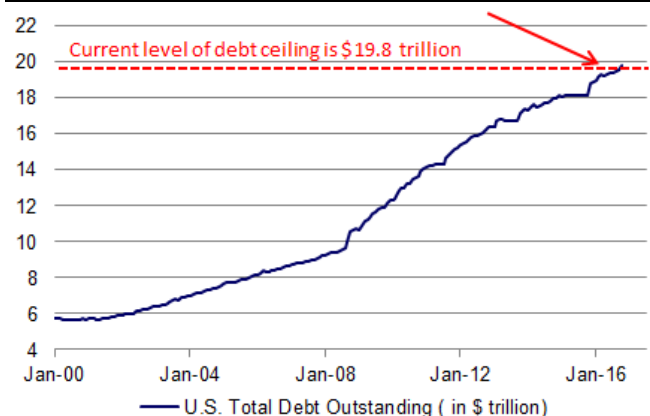
Conclusion: The NAFTA negotiations will not have an impact on \$/Canada.

Dollar: The debt ceiling debate

Time and time again the U.S. debt ceiling becomes a renewed subject for markets. Could anyone really imagine a US default though? No one questions the ability of America to pay, especially since the nation has never repudiated its debt. Late September and mid-October the clock runs out and Republican leaders are confident that differences can be set aside. In the Trump era, anything could happen given the new administration, as we have seen with healthcare repeal, tax reform, and other policy debates. We see investors avoiding U.S. T-bills earlier than is usual, pushing up the yield to its highest since 2008. The Trump government isn't like any recent government but much more volatile. Back in May, Trump even said that the U.S. could do with a "good shut-down" to fix the "mess". What is really at stake with a US government shut-down?

America’s credibility in the global debt markets is a big one. According to Bloomberg, the U.S. government owes 7bio dollars in interest by October 2, in addition to 48bio dollars for Medicare, benefit payments for civil service and military retirees and pay for active-duty military members. Even if people feel that a default is negligible, it is riskier to hold a paper that matures shortly after September 29.

Current level of US debt ceiling



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: While we feel a U.S. default risk is negligible, the outlook is more uncertain than in 2015 causing October Treasury bill maturities to underperform.

QUICK NEWS HEADLINES (time in CET)

The following two headlines might have an impact on currency markets today:

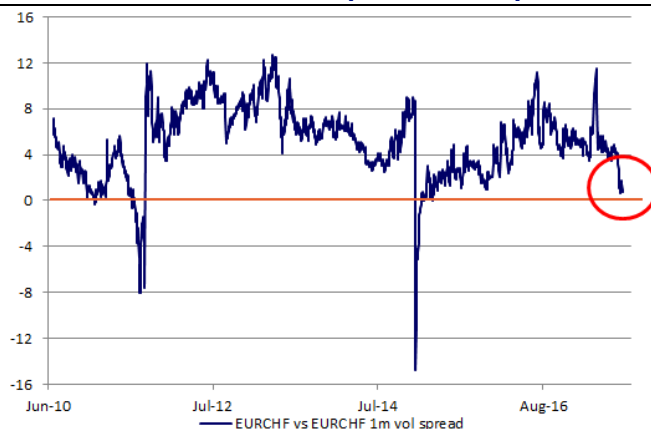
- JP Exports and Imports Y/Y (01:50)
- UK Retail Sales Y/Y (10:30)
- EC Trade Balance (11:00)
- EC CPI Y/Y 11:00
- ECB Minutes (13:30)
- US Industrial Production M/M (15:15)

Franc: Safe haven currencies revisited

The yen and franc are favoured safe haven currencies. In a risk-off event, both of these currencies tend to gain in value. The yen is generally considered to be the more volatile currency of the two. Back in 2015 when the SNB removed the floor on the € / franc, the swings of the € / franc surpassed the € / yen only for the € / yen to gain in volatility versus the € / franc again shortly thereafter. Now, for the first time since April 2015, the volatility spread is about to be reversed again with the franc becoming more sensitive to geopolitical risks and € / franc breaking out of its two year range. One-

month realized vol in € / franc is now at its highest level since July 2016 with implied vol remaining bid. One of the possible reasons behind this move could be that investors prefer the franc to the yen due to the yen’s proximity to North Korea, with Japan stating their intention to intervene with any missiles being fired off from North Korea to Guam.

€ / yen vs € / franc 1month implied volatility



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: The franc is surpassing the yen as a safe haven currency, leading to increased volatility in the franc.

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